CALIFORNIA
High-Speed Rail Authority

January 3, 2012

The Honorable Darrell Steinberg
Senate President Pro Tem
State Capitol Building
Room 205
Sacramento, California 95814

The Honorable Bob Dutton
Senate Republican Leader
State Capitol Building
Room 305
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The Honorable John Perez
Speaker of the Assembly
State Capitol Building
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The Honorable Connie Conway
Assembly Republican Leader
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Room 3104
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Re: Response of the California High Speed Rail Authority to the Report of the Legislative Peer Review Group

The California High Speed Rail Authority has reviewed the report submitted today to the California Legislature by the California High Speed Rail Peer Review Group.

While some of the recommendations in the Peer Review Group report merit consideration, by and large this report is deeply flawed, in some areas misleading and its conclusions are unfounded.

Unfortunately, many of the most egregious errors and unsupported assertions would have been avoided with even minimal consultation with the CHSRA. Although some high-speed rail experience exists among Peer Review Panel members this report suffers from a lack of appreciation of how high speed rail systems have been constructed throughout the world, makes unrealistic and unsubstantiated assumptions about private sector involvement in such systems and ignores or misconstrues the legal requirements that govern the construction of the high speed rail program in California.

In recommending against proceeding with the high speed rail development "at this time," the Report ignores many components of the CHRSA's recent Draft Business Plan and attempts to promulgate a new standard of project feasibility that is inconsistent with national funding of transportation projects.

The report's conclusions, which would be premature at best, would place at risk $3.5 billion of federal funding for High Speed Rail currently in hand for the project and undermine extensive outreach efforts on the part of the Authority to develop greater integration with regional rail systems.

Consequently, the Authority believes this report does not provide a sound basis for critiquing the Authority's Finance plan, nor for the public policy choices facing the Legislature.

A detailed response to specific issues is below:

1. Timing:

The Committee notes that it is responding to the Financing Plan submitted November 3, 2011 and concurrently preparing a response to the Draft Business Plan submitted November 1, 2011. The Committee notes that it is "unfortunate that the CHSRA Board certified the Funding Plan simultaneously with the issuing of the draft 2012 Business Plan" since the finalization of the Business Plan may (and likely will) result in some modifications to the Financing Plan. The Authority released each of these documents in conformance with statutory requirements. As noted, the finalization of the Business Plan may result in material changes to the Financing Plan. This should have been clear to the Committee and consultation with the Authority, which did not occur, would have eliminated any confusion on this point.

2. Feasibility:

Phasing and Blending

The Committee endorses the decision by the CHSRA to adopt phasing and a so-called blended approach to intermediate high speed rail service in urban areas. This blended approach, which makes use of existing track and rights-of-way, had been propounded by key state and federal legislators as a means to reduce impacts, costs and public opposition to the development of high speed rail. The CHSRA fully embraced the blended approach concept in the Draft Business Plan. However, the Peer Review Committee then recommends that the Authority suspend further planning for further build out towards the previously defined Phase 1. This recommendation, which has no relevance to the immediate Financing Plan, flies in the face of the plain language of Proposition 1A. Moreover, as a consequence, the Authority would have to abandon further planning efforts to integrate high speed rail into the Transbay Terminal in San Francisco, which is specifically denoted as the "northern terminus" for the high speed rail line.

In addition, suspending planning for the full Phase 1 build out would have the unintended consequence of threatening the use of Proposition 1A bond money for advanced investments in blended segments, in that the Authority could not find that such expenditures were consistent with a segment "ready for" full high speed rail service. This recommendation is ill-considered and was not a necessary element of analysis for the Financing Plan.

ICS/OIS Distinction

The Committee Report, after stating that it would not comment on legal questions pertaining to Initial Construction Section, then proceeds to do so and arrives at the wrong conclusion, by stating that:

"…the ICS as planned is not a very high-speed railway (VHSR), as it lacks electrification, a VHSR train control system and a VHSR compatible communication system. Therefore it appears not to meet the requirements of enabling State legislation."

The Committee has no legal competence to enable it to make such a statement and the Authority rejects this assertion. Attorneys for the Authority and others elements of the State of California, as well as attorneys for the Federal Railroad Administration, have reached the opposite conclusion and are fully comfortable that the Initial Construction Segment is complaint with the state bond measure. It is also noteworthy that the legislative author of the bond measure has embraced this view as well.

The Committee states that "The fact that the Funding Plan fails to identify any long term funding commitments is a fundamental flaw in the program." In so stating, the Committee attempts to set a standard that is simply not used for any other transportation program. By this measure, none of the unconstrained regional transportation plans of any transportation authority should be pursued. No project, in our experience, has fully identified funding sources for the entire project at this stage and it is both unfortunate and inappropriate for the Committee to apply this test only to high speed rail.

The Committee attempts to distinguish the high speed rail project because it does not have a "dedicated funding source" such as the Highway Trust Fund or Airport Improvement Funds. This analogy ignores the fact that the High Speed Rail project has funding in hand for the Initial Construction Segment, which even the Committee admits will have independent utility if constructed. Furthermore, the mere existence of a dedicated funding stream is no guarantee that any specific project or program will be funded. By this metric suggested by the Committee, Interstate 5 would not have commenced construction, despite the presence of the Highway Trust Fund.

Nor does the Committee recognize that the President has proposed that high speed rail be provided a dedicated funding stream in the reauthorization of the Surface Transportation Act. Accordingly, the High Speed Rail program is not significantly different in terms of its funding at this stage than are other major infrastructure initiatives.

Moreover, the suggestion that the high speed rail project be placed on hold because there is not a "dedicated funding source" ignores the clear mandate of the Legislature and the people of the State of California pursuant to the provisions in the Proposition 1A Bond Act (Act). Under the Act, $9 billion of bond proceeds were approved to initiate the construction of a high-speed rail system using these State bond monies as matching funds with other private or public funds, including federal funds. The CHSRA has now secured $3.5 billion in federal matching grant monies that have no cost to the people of California so that the mandate of the Act can be met. Nowhere in the Act is there a requirement that any particular amount of non-State matching funds be committed prior to the initiation of the start of the high-speed rail project. Nowhere in the Act is there a requirement that the project must be funded using a "dedicated funding source." Future non-State match funding will be pursued by the CHSRA to progress the project beyond the Initial Construction Section in the Central Valley. Any delay in proceeding with the Initial Construction Section at this time will result in the loss of the existing $3.5 billion in federal funding and will likely jeopardize the possibility of any future federal funding for a California high-speed rail system.

The Committee fails to assess the risks of not proceeding with the program at this juncture. Those risks include the irretrievable loss of $3.5 billion of federal funds, the potential elimination of state funds, the impact on regional rail systems of the loss of $950 million in funding for "interconnectivity" which are tied to progress on the high speed rail development, the inevitable increase in costs of eventual high speed rail connection through California as a result of inflation, population growth, etc., the loss of economic opportunity and technology development. These risks are present and real and represent lost opportunity of enormous cost and lasting consequence.

The statement "Further, the ICS will not be electrified, and thus cannot serve as a high-speed test track for future VHSR rolling stock[3]" is misleading. The Authority never intended to use an un-electrified ICS as test track. Furthermore the foot-note (3) is also misleading to the public, as the AAR's test track at Pueblo, CO cannot be used to test true high-speed rail systems as it does not have the capacity to test at 250 mph, although the mention of this facility in this report seems to indicate that this may be possible.

Business Model:

It is not clear why the Committee felt compelled to comment on this issue in its review of the Financing Plan for the Initial Construction Segment, since it is not a matter of consequence at this time. Having delved into this area, the Committee again reaches erroneous and inconsistent conclusions.

First of all, the Committee ignores the clear statements of the Authority that its "Business Model" relies heavily on private sector involvement, anticipating that private operators will provide the rolling stock and operations and maintenance. The Authority would be pleased to see private sector investment at the earliest possible stage of the project. In our Draft Business Plan, the Authority has made the conservative, but realistic assumption, that no such investment will be forthcoming until a ridership level is established (an accelerant for private investment would be a revenue guarantee in advance of demonstrated ridership; the Authority explicitly rejected any revenue guarantee in its Finance Plan as being inconsistent with Prop 1A nor prudent policy).

The Committee complains that building the ICS or IOS without private operator involvement is not a "feasible" business model and states:

"Without input from the final private sector participant regarding route alignment and station location, the future value of the HSR concession/franchise may be greatly diminished and less attractive to potential private sector participants. In other words, the private sector needs to be brought into the process much sooner than currently planned."

This conclusion is extremely simplistic and displays a lack of knowledge of the realities of private finance for such complicated projects. It is also not supported by any experience throughout the world for a project of this magnitude, of which we are aware.

As this canard has been reiterated by the Committee, it is worth a response in detail. Let's compare the experience in other successful High Speed Rail systems:

- In Japan the network and the operations were built and funded by the Public sector (Ministry of Transportation). At a much later date they privatized the operations.

- In Germany and France the Ministries of Transportation decided on the routes and the funding, then turned to infrastructure companies (DB-Netz and RFF) responsible to build and own and operate the infrastructure (including some PPP components); they have associated operators (DB and SNCF), but they all are government-associated companies. Neither of these systems is thus operated by private operators.
- In Spain, when they decided to introduce HSR, they did their own designs (and still continue to do so today), and subsequently the AVE service was introduced on the lines being operated by Renfe. This is similar to having Amtrak being involved and operating the system in the end. But this has not resulted in a private operator.
- Companies such as Virgin Rail who operate on existing infrastructure in the UK, as the infrastructure was there and the government decided to farm out the operations as a concession.
- The latest example in Italy, where NTV will be operating HSR trains on existing infrastructure, supplying trains and depots, but having had no input into the system designs.

While it may make a good sound bite in theory to have a private operator on board from the start, it is neither practical nor feasible. There is also no example of this being done successfully anywhere in the world. The one case where a government turned to full privatization of HSR from the outset occurred in Taiwan, which experienced many problems as a result, and was much reduced in size compared to the California program.

Indeed it is a problem to decide on an operator too early. Choose a German company and you are most likely tied into German technology for the entire project; the same is true for French or Japanese operators. This eliminates all competition at a later date.

It is also the case that the California High-Speed Rail Authority will be "selling" a concession to a private operator, giving them the right to operate and maintain the system. In doing so, the Authority will be seeking the best deal for California. Entering into such an agreement too early in the process will lead to lower revenues from the concession company, as private investors seek to discount the amount to reflect the risk of revenue variability.

As this is a system for the people of California, the basic alignment is laid down by law (Prop 1A) and the major stations are determined. So it will not be possible for an operator to change these basic parameters. Furthermore the process is driven by CEQA and NEPA which again is not the strength of international operators. So, although international operators are important to consult (and many provided favorable peer review of our Operations & Maintenance Plans), it is simply wrong and not feasible to suggest that those operators must be brought in at this point.

To the extent the Committee can point to a comparable circumstance where what they recommend has been put into practice, the Authority will gladly review and consider alterations to our approach. Until then, we believe the Committee demonstrated its lack of understanding about how high speed rail has been built throughout the world.

Finally, we note that one of the promising U.S. opportunities for private participation in high speed rail development was in Florida, where a number of infrastructure companies were expressing interest in the Florida program on the very day when the Governor of that state announced he was returning federal funding. The resulting loss of confidence from the private sector was striking. The Committee's report, if embraced by the Legislature, will similarly dampen enthusiasm of private investors to look to California.

Inadequate Management Resources:

The Authority agrees with this critique, as we've stated publicly. We are moving aggressively to address this issue.

Demand Forecasts:

The Committee's commentary on the Demand Forecasts employed by the Authority is without foundation. The demand model has been independently peer-reviewed, by recognized experts, including some recommended by the UC Institute of Transportation Studies. Moreover, the Committee ignores the break-even analysis that shows the robustness of the demand forecasts in showing that ridership will meet operating cost thresholds. That is the crucial element of the ridership model and so far, no person has questioned those results. Nevertheless, there exists extensive documentation on the ridership model that is available for public review, and was also published as attachment to the Draft Business Plan. The Committee's discussion of the ridership model is therefore gratuitous and without foundation.

Capital Costs:

The Committee's discussion of capital costs is lacking in several respects. First, the Committee ignores the highly conservative estimates of inflationary effects embedded in the Draft Business Plan. The Authority has planned for potential inflationary effects that equal some $30 billion or 1/3 of the capital cost. This number is substantially higher than standard inflationary estimates. Second, the Draft Business Plan has provided substantial contingencies to deal with overruns. Third, the Committee's assertion that capital costs are not understood at the 15% design level is an opinion with which we disagree.

The Committee attempts to compare the cost per mile of a light rail system built in urban areas with a high speed rail system built substantially outside of urban areas. Such a comparison is meaningless.

The Committee demonstrates a complete misunderstanding of the ICS construction. It notes as a more important factor, that no low or high estimate is given. However, a plain reading of the Finance Plan and Business Plan shows that the ICS will be constructed up to 130 miles. Its actual length may vary slightly to the extent that land acquisition, construction and environmental mitigation costs are higher. Nor does the Committee acknowledge the construction of the ICS will proceed under a design-build contract, thereby minimizing even further the actual risk of construction cost overruns. The failure of the Committee to either discuss the actual features of the ICS construction is a significant defect in their report, one easily avoidable through even rudimentary analysis and consultation.

The Committee should have recognized that as the ICS costs were capped at $6B (YOE), the IOS-north and IOS-south cost estimates included the full incorporation of high and low cost scenarios, thereby compensating for the possible alternatives within the IOS (which includes the ICS section).

Risk Minimization:

In this section, the Committee reveals its true bias, which is that the funds should be transferred from the Central Valley to those ends of the system where greater populations are found. This has been a persistent line of attack on the high speed rail plan. Unfortunately, the Committee's analysis is deeply flawed. It assumes, with no evidence, that funding could be shifted to those projects it favors. The Committee has been told that federal funding could not be adjusted in this way. The Committee ignores the very provisions of Prop 1A to which it referred earlier in questioning the ICS; it is not at all clear that Prop 1A funds could be used in the manner suggested (outside of the $950 million specifically identified for interconnectivity; funds that would also be in question if the Committee's ultimate recommendations are adopted). This is especially true in areas that have no current plans for electrification of their systems.

The constant reference to nearly 28 million passengers using regional transit systems and comparing that to the 1 million San Joaquin passengers of today is totally misleading. The high-speed rail system is no regional transit system and the construction of the ICS is the first step to connect the metropolitan centers of northern California with the metropolitan centers of southern California. A similar comparison between the number of people making automobile trips every day and those taking transit would not lead to the desired decision to invest in rail transit systems rather than more freeways.

Unfortunately, this entire section of the report is devoid of critical analysis of what would happen in reality if the Committee recommendations were adopted. The Committee seems unaware or unconcerned that the growing level of cooperation between the CHSRA and regional rail operators would be stifled, not enhanced, by its recommendations.

Conclusions

The CHSRA has acknowledged that there will be challenges to overcome in developing a complex HSR program for California. At the same time, the benefits are many, in terms of short and long term economic development, smart growth, and the avoidance of more costly and damaging mobility alternatives. The risks of going forward must be understood and managed. The Committee's analysis of those risks is open to question on many grounds (by its own terms the Report indicates it cannot really assess the project until the final Business Plan is developed). Perhaps most important, the Committee did not consider, address or analyze the risks of not proceeding with the project. Those include lost opportunities for funding, for securing right of way, for avoiding inflationary effects, alternate investments in other transportation solutions to meet the inter-state transportation needs among others.

Of greatest importance, the Report fails to address or acknowledge the even greater costs of meeting the State's mobility needs in the absence of high-speed rail. As the Authority's draft Business Plan has demonstrated, those costs for expanded highways, roads, and airport facilities are significantly higher and their environmental impacts far more serious. There are no clear available sources of funding those mobility alternatives, which, unlike HSR, also require billions of dollars for ongoing maintenance support.

As the report presents a narrow, inaccurate and superficial assessment of the HSR program, it does a disservice to policy-makers who must confront these decisions.

Sincerely,

Thomas J. Umberg, Chair
California High-Speed Rail Authority

Cc:

Hon. Bob Huff, Senate Republican-Elect Leader
Hon. Mark DeSaulnier, Chair, Senate Transportation and Housing Committee
Hon. Ted Gaines, Vice Chair, Senate Transportation and Housing Committee
Hon. Alan Lowenthal, Chair, Senate Select Committee on High Speed Rail
Hon. Bonnie Lowenthal, Chair, Assembly Transportation Committee
Hon. Kevin Jeffries, Vice Chair, Assembly Transportation Committee
Hon. Cathleen Galgiani, Chair, Assembly Select Committee on High-Speed Rail for California
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